STATE OF MICHIGAN

IN THE SUPREME COURT

MENARD, INC.,

Petitioner-Appellant,

vs.

CITY OF ESCANABA,

Respondent-Appellee.

Supreme Court Case No. 154062

Court of Appeals No. 325718

Michigan Tax Tribunal
Docket Nos. 441600 and 14-001918
(Consolidated)

Dykema Gossett PLLC
Carl Rashid, Jr. (P23915)
Jill M. Wheaton (P49921)
Gina Torielli (P45275)
Blair D. Gould (P79161)
Attorneys for Petitioner-Appellant
400 Renaissance Center
Detroit, MI 48243
313-568-5422
crashid@dykema.com
jwheaton@dykema.com

Foster Swift Collins & Smith PC
Jack L. Van Coevering (P40874)
Laura J. Genovich (P72278)
Attorneys for Respondent-Appellee
1700 East Beltline, N.E., Suite 200
Grand Rapids, MI 49525-7044
616-726-2221

REPLY TO RESPONDENT-APPELLEE CITY OF ESCANABA'S ANSWER TO APPLICATION FOR LEAVE TO APPEAL OF PETITIONER-APPELLANT MENARD, INC.

ORAL ARGUMENT REQUESTED

PROOF OF SERVICE

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

ARGUMENT

I. LEAVE TO APPEAL SHOULD BE GRANTED BECAUSE THE DECISION OF THE COURT OF APPEALS INVOLVES LEGAL PRINCIPLES OF MAJOR SIGNIFICANCE TO THE STATE'S JURISPRUDENCE, NAMELY, THE PROPER METHOD OF ASSESSING COMMERCIAL AND INDUSTRIAL REAL PROPERTY IN THE STATE OF MICHIGAN

A. The Court of Appeals Expanded The *Clark* Decision And Incorrectly Adopted A "Value In Use" Standard For Big Box Retail Stores

The City wrongfully contends that Menard tries to classify the cost approach as a "value in use" standard. (Respondent/Appellee City of Escanaba's Answer to Application for Leave to Appeal ("Resp"), p. 23.) Not true; Menard agrees that the two are not synonymous. Value in use is a hypothetical amount attributed to the use of the property by the owner and includes the costs of improvements and alterations regardless of whether such improvements or alterations affect a property's market value. The cost approach is the cost of the property which accounts for depreciation and obsolescence, both functional and external, to arrive at the property's true cash value. This is harmonious with Michigan's requirement that property be assessed at its true cash value, established as market value, not value to the owner.[1] Rather, Menard argues that, as the Tax Tribunal properly found, the City's use of the cost approach in this case failed, among other things, to account for any obsolescence calculation, which amounted to a value in use determination contrary to Michigan law, requiring review by this Court.

Moreover, in considering whether to use the cost approach for the subject property, Menard's appraiser Mr. Torzewski stated:

---

[1] To the City's argument that Menard did not previously argue the "value in use" theory and therefore did not preserve the issue for appeal (Resp., p. 24), Menard did not use this specific term before because the Court of Appeals created this issue in its published Opinion. It was not an issue until the Court of Appeals issued its published opinion and made Michigan a "value in use" state for certain types of properties. Therefore waiver is not an issue. *See e.g., Booth Newspapers, Inc v Univ of Mich Bd of Regents*, 444 Mich 211, 234 n 23; 507 NW2d 422 (1993).)

> [F]or the most part buyers of these properties just don't utilize the cost approach when they're looking to buy a property. They're looking at sales of similar properties and identifying how much people are paying for them and using that as their basis to determine what they're willing to pay."

(HT, p. 60.) This is consistent with recent decisions of the Court of Appeals.[2]

The City also argues that Menard either "misunderstands or misconstrues" *Clark Equipment Co v Leoni*, 113 Mich App 778; 318 NW2d 586 (1982) (Resp., p. 25.) However, as noted in Menard's Application, *Clark* relied on a decision that was subsequently overturned by this Court in *First Federal Savings & Loan Ass'n v City of Flint*, 415 Mich 702; 329 NW2d 755 (1982). *Clark* held, at the time in accordance with the later reversed Court of Appeals opinion in *First Federal Savings*, (104 Mich App 609; 305 NW2d 553 (1981)) that a large industrial facility could be valued utilizing a value in use standard when no market exists for such facilities. 113 Mich App at 785. Although *Clark* was not appealed to this Court, this Court reversed the *First Federal Savings* Court of Appeals' opinion just nine months later, noting that "[w]hile actual and reproduction cost are some evidence of value, the *constitutional and statutory standard is market-based*."[3] 415 Mich at 705 (emphasis added.)

---

[2] *See e.g., Lowe's Home Ctrs, Inc v City of Grandville*, unpublished opinion per curiam of the Court of Appeals, issued December 30, 2014, p. 2 (Docket No. 317986) (Ex. E to Application) (affirming the Tribunal's decision to reject the city's cost approach after Lowe's appraiser stated "[h]e did not provide … a cost approach because he considered it an unreliable method of determining the market value … because prospective buyers of such property did not generally make their decisions to purchase based on a cost-approach ...") and *Lowe's Home Ctrs v Twp of Marquette*, unpublished opinion per curiam of the Court of Appeals, issued April 22, 2014, p. 3 (Docket Nos. 314111 and 314301) (Ex. E to Application) (appraiser for both Petitioners, Lowe's and Home Depot, "used the sales-comparison approach as the primary indicator of value" while the "the cost approach is not considered a primary indication of value; rather it will serve as a check to the value conclusions reached via the income and sales approaches." The municipality respondents in *Lowe's v Marquette* filed an application for leave to appeal to this Court, which was denied. (Supreme Court Case Nos. 14907, 14908; Dec. 23, 2014 Order.)

[3] *See also Thrifty Royal Oak, Inc v Royal Oak*, 130 Mich App 207, 222; 344 NW2d 305

It is clear, and was always understood, that *Clark* is a narrow exception to the rule rather than the standard, but the Court of Appeals' Opinion has now put that into question. Since the 1982 *Clark* decision, and especially post-2008 recession, there have been numerous sales of commercial properties similar to the subject property. With the existence of an active market, the selling price more closely reflects true cash value. *Teledyne Continental Motors, Inc v Muskegon Township*, 163 Mich App 188, 194; 413 NW2d 700 (1987); *see also First Federal Savings*, 415 Mich at 706. But as a result of the Court of Appeals' published opinion, certain retail properties can no longer be assessed based on comparable sales, and must be assessed according to *Clark's* value in use concept.

Contrary to the City's argument, the cost approach was considered but rejected by the Tribunal and Menard presented substantial evidence of an adequate market of comparable properties. The City's contention that Menard ignores two previous decisions of the Court of Appeals fails to recognize that these cases are from 1984 and 2000 (before a market developed for big box stores).[4]. Although not relied on in Mr. Torzewski's report, he included a chart of thirty other comparable sales as additional support and confirmation that the sales comparison valuation was "in the ballpark" and a very active market exists for these types of properties. (HT, pp. 55-56.)

Consistent with the City and *First Federal*, Menard agrees that the cost approach may be used if expenditures that "merely enhance the image" or business of a property owner were discounted from historical cost (called "functional obsolescence"). However, the City's assessor

---

(1983) (reversing the Tax Tribunal's value in use approach because the Tribunal relied heavily on *First Federal*, which was later reversed.)

[4] Resp., p. 30, relying on *Meijer, Inc v City of Midland*, 240 Mich App 1; 610 NW2d 242 (2000) and *Thrifty Royal Oak v City of Royal Oak*, 130 Mich App 207; 344 NW2d 305 (1984).

merely accounted for physical deterioration based on the subject property's age but did not account for functional obsolescence "[b]ecause there are other retail uses that would use the components of that building". (HT, pp. 188-89.) That may be true, but functional obsolescence is inherently built into each business's building to fit its respective image and operating needs and the City's assessor's testimony reveals this much. An allowance must be calculated and deducted from the cost calculation (value in use) to convert it to market value (value in exchange), which the City and its assessor simply ignore in this case.

Evidence concerning obsolescence was presented to and considered by the Tax Tribunal. Even if the cost approach is used, in determining the true cash value under that approach, the physical deterioration, functional and external obsolescence must be accounted for. *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 484; 473 NW2d 636 (1991). As stated above, a cost approach valuation without the appropriate adjustments fails to comprise a value in exchange standard, and the Court of Appeals' decision is in error and has significant ramifications.

B. The Court of Appeals' Decision Will Affect Many Properties

The City also argues that – despite its published status -- the Court of Appeals' Opinion will not have an effect on the future assessment of commercial and industrial properties and that this Court should refrain from rendering a decision in the wake of pending legislation. (Resp, pp. 39-42.)

First, the City claims that the Court of Appeals' Opinion does not hold that the cost-less-depreciation approach must be used in this case and does not "toss" the sales comparison approach. (Resp, p 39.) But by way of its expansion of *Clark*, and notation of "the prevalence of the self-imposed deed restrictions on big-box stores" (Opinion, p. 8.), the Opinion does indeed essentially adopt a blanket cost valuation methodology (i.e., value in use) for "big box stores",

and other commercial and industrial properties. Because of the frequency of use restrictions on "big-box stores," such properties can no longer be assessed based on comparable sales, and must be assessed according to a cost-less-depreciation approach. Deed restrictions and other use restrictions are commonplace on commercial properties, such as the subject property, as well as shopping mall and retail developments, but these restrictions generally do not affect the value of the property. In a typical sale of a so-called "big box store", the purchase price is established first and the restrictions are negotiated afterwards. In the instant case, the deed restrictions the City identified apply only to limiting the size of a discount store to less than 50,000 square feet and the size of a grocery store to less than 35,000 square feet, the same size as previously used by the seller. Most discount stores and grocery stores are under these square footages, and thus have no practical effect of restricting that retail use as a typical "Walmart" or similar retail store would have a grocery store or discount store of that size. (*Id.*, pp. 65, 119). Simply stated, it was determined by the Tax Tribunal Judge and Petitioner's expert that these deed restrictions did not impact the sale price of these comparables.

The Court of Appeals' approach is in direct contravention to Michigan law by allowing the use of the cost approach method of valuation without the requisite deductions for depreciation and obsolescence components simply because the assessor states that none exist – amounting to a value in use standard. At best, the Opinion will result in confusion as to whether Michigan remains a value-in-exchange state, and it directly conflicts with established legal principles of the State of Michigan. Either way, it is significant and clarification from this Court is needed.

That there is legislation pending before the Senate on the valuation issue – a fact on which the City heavily relies -- is unpersuasive. First, the Legislature may not come to an

agreement on the issue. If this Court were to put the brakes on every application where the Legislature was considering that area of the law, little would get done in many areas (No-Fault law, to cite but one example, where there are virtually always bills in circulation seeking to change the law). The question before the Court is whether the Court of Appeals properly interpreted and applied the existing law, not if they accurately predicted what the law may eventually become. (And even then, the law may not be static -- the two laws passed by Indiana in 2015 which specified how to value big-box retail properties were both repealed less than a year after their adoption, and two previous bills pending in the Michigan legislature concerning valuation of big-box stores failed to pass.) In fact, that such legislation is pending proves that this is a significant issue on which this Court should opine. .

II. LEAVE TO APPEAL SHOULD BE GRANTED BECAUSE THE COURT OF APPEALS' OPINION IS CLEARLY ERRONEOUS, IN THAT THE COURT SECOND GUESSED THE TAX TRIBUNAL'S WEIGHT AND CREDIBILITY DETERMINATIONS AND EXCEEDED THE PROPER SCOPE OF ITS STANDARD OF REVIEW

Both parties agree that the Court of Appeals must consider the entire record on review. However, in the instant case, the Court of Appeals simply substituted its judgment for that of the Tax Tribunal. Throughout its Opinion the Court of Appeals made its owns weight and credibility determinations relating to both parties' expert testimony, their respective appraisals, and other documentary evidence, which is clearly erroneous and will cause material injustice if not reversed. Contrary to the City's allegations, the Tax Tribunal applied generally accepted appraisal methods and determined the highest and best use of the subject property. Menard presented substantial evidence that: (i) the deed restrictions had no effect on the comparable properties' sales prices; (ii) Mr. Torzewski made appropriate adjustments in his sales comparison analysis; and (iii) Mr. Torzewski's sales comparison approach provided the most accurate true

cash value for the subject property for the tax years at issue sufficient to arrive at an independent determination of value.

Considering the entire record, the Tax Tribunal found that, on the other hand, the City's assessor lacked valuation experience, her cost approach "did not account for functional or external obsolescence," and noted several "inconsistencies, contradictions and misrepresentations" in the City's documentary and testimonial evidence (FOJ, pp. 12-14; 16.) The Tax Tribunal rejected the City's cost approach and appropriately exercised its discretion when it gave more weight to Menard's evidence – finding Mr. Torzewski more credible than the City's assessor. Overall, the Tax Tribunal found Menard's "application of available data to the subject property [ ] persuasive" and the "comparison analysis and adjustments reflect[ed] market actions" and agreed with Menard's sales comparisons. (FOJ, pp. 16-17.)

Because the Tax Tribunal found Mr. Torzewski's appraisal and testimony credible, the Court of Appeals should not have second-guessed that weight and credibility determination. *See e.g, Detroit Lions, Inc v City of Dearborn*, 302 Mich App 676, 703; 840 NW2d 168 (2013) ("We do not disturb the [Tribunal's] findings regarding the credibility of the witnesses. It is exclusively for the tribunal to assess the credibility of the witnesses ..."). The Court of Appeals also stated "[i]t is plain that no adjustments" were taken for the deed restrictions and concluded that "the tribunal erred in finding Menard's sales-comparison approach meaningful." (Opinion, p. 8.) However, the Court of Appeals disregarded the evidence and Mr. Torzewski's testimony concerning deed restrictions and found that the comparables "did not reflect the full value of the unrestricted fee simple" simply from the presence of restrictions (Opinion, p. 8.) This directly contradicts the Tax Tribunal's finding, on reconsideration, that Menard's comparable sales are

"still fee simple transactions, as the grantees in those transactions obtained full ownership rights in the property." (CFOJ, p. 3.)

The Tax Tribunal's factual findings are conclusive if supported by competent, substantial, and material evidence on the whole record. *Briggs Tax Service, LLC v Detroit Pub Schools*, 485 Mich 69, 75; 780 NW2d 753 (2010); Const 1963, art 6, § 28. "Substantial" means evidence that a reasonable mind would accept as sufficient to support the conclusion. *Kotmar, Ltd v Liquor Control Comm*, 207 Mich App 687, 689; 525 NW2d 921 (1994). The foregoing demonstrates that, after considering the entire record, a reasonable person would accept Menard's and Mr. Torzewski's evidence as sufficient to support the Tax Tribunal's conclusion and thus, the Court of Appeals erred in reversing.

The Tax Tribunal considered each of the traditional approaches to valuing property, analyzed the strengths and weaknesses of each appraiser's valuation methods under the respective approaches, assessed the credibility of witnesses and weighed the evidence presented, selected the method which it found to be the most accurate after considering all the facts before it, and explained the reasoning behind its independent determination of value. *See e.g. Great Lakes*, 227 Mich App at 407, 413, and *Huron Ridge LP v Ypsilanti Twp*, 275 Mich App 23, 28; 737 NW2d 187 (2007). The Court of Appeals should have affirmed, but instead, violated the standard of review by making its own determinations regarding the evidence. Accordingly, the Court of Appeals' Opinion is clearly erroneous, will cause material injustice, and conflicts with prior decisions of this Court and the Court of Appeals.

CONCLUSION

For the reasons set forth above, Petitioner-Appellant respectfully requests that this Court grant its Application for Leave to Appeal, and on appeal, reverse the Court of Appeals' May 26, 2016, Opinion, and reinstate the Tax Tribunal's Corrected Final Opinion and Judgment.

Dated: September 8, 2016

Respectfully submitted,

DYKEMA GOSSETT PLLC

By: /s/ Carl Rashid, Jr.

Carl Rashid, Jr. (P23915)
Jill M. Wheaton (P49921)
Attorney for Petitioner-Appellant
400 Renaissance Center
Detroit, MI 48243
(313) 568-5422
crashid@dykema.com
jwheaton@dykema.com

CERTIFICATE OF SERVICE

On September 8, 2016, I e-filed this Reply to City of Escanaba's Answer to Application for Leave to Appeal with the Michigan Supreme Court and served a copy of this Application upon:

Clerk of the Court
Michigan Court of Appeals
Hall of Justice
925 W. Ottawa St.
P.O. Box 30022
Lansing, MI 48909-7522

by attaching a copy of this filing to Notice of Filing Plaintiff-Appellant's Reply to City of Escanaba's Answer to Application for Leave to Appeal in the Michigan Supreme Court and electronically filing document using Court of Appeals ECF system. Also served a copy of this Reply to City of Escanaba's Answer to Application for Leave to Appeal upon:

Jill Andreau, Clerk
Michigan Tax Tribunal
P.O. Box 30232
Lansing, MI 48909

by enclosing copies of the same in envelopes properly addressed, and by depositing said envelopes in the United States Mail with postage thereon having been fully prepaid.

Respectfully submitted,

DYKEMA GOSSETT PLLC

By: /s/ Carl Rashid, Jr.

Carl Rashid, Jr. (P23915)
Jill M. Wheaton (P49921)
Attorney for Petitioner-Appellant
400 Renaissance Center
Detroit, MI 48243
(313) 568-5422
crashid@dykema.com
jwheaton@dykema.com